Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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Profits Take It On The Chin

Hit hard by declining "real" final sales, escalating labor costs and rising financing costs, many U.S. corporations reported lower earnings during the second quarter compared with the first. According to preliminary estimates by this Bank, profits from current production plunged by more than 13 per cent in the second quarter. Increasing costs combined with mounting inventories produced the steepest quarterly decline in earnings since the 15 per cent slide a year ago. That, in turn, was the sharpest drop in more than 26 years. When inventory profits are subtracted, last quarter's decline is even greater, topping 15 per cent. Notwithstanding this large quarter-to-quarter decline, second-quarter 1981 operating earnings were still 4¼ per cent higher than they were a year ago. However, comparisons with the weak second quarter, 1980 outcome may be misleading since demand during that time period was artificially depressed by the Fed's credit controls.

The weakness was not confined to the long-suffering metals, housing, airlines and auto industries. Poor earnings were also reported by such previously prosperous areas as high technology, because the demand for semi-conductors and business equipment waned. The outlook for profits continues to be mixed. On the one hand, they will be boosted by accelerated spending resulting from the personal tax cuts likely to take effect October 1. On the other hand, reported profits will be dampened by the accelerated depreciation schedules for business also contained in the tax cut package.

Corporate Casualties Climb

The persistently high level of interest rates was one of the reasons for many industries' poor performance. As the prime rate hovered around 20 per cent and inventories accumulated at the fastest quarterly pace in five years, financing costs—especially in the retail trade sector—skyrocketed. The high cost of money not only squeezed corporate balance sheets, but also significantly boosted the bankruptcy rate.

Commercial and industrial bankruptcies started their most recent upward climb in early 1980—about six

INDEX OF BUSINESS FAILURES PER 10,000 FIRMS (LINE)
VS. 6-MO. LAGGED REAL PRIME RATE (DOT)

months after real interest rates began to spike upward (see chart). Many U.S. corporations began to rely excessively on short-term borrowing thus leading to a marked deterioration of corporate balance sheets. Meanwhile, short-term interest rates reached historic highs during the period. Combined with the sluggish performance of the economy since second-quarter 1979 (Financial Digest—July 27, 1981), it is hardly surprising that corporate financial health has deteriorated. Failures reached a 13-year high in 1980, and liabilities rose to record levels.

The most significant increases in bankruptcies during 1980 occurred in the commercial services sector and in the interest sensitive construction sector. However, during the first seven months of 1981, an increased number of bankruptcies was particularly evident among manufacturing establishments.

There appears to be a six-month lag between the change in "real" interest rates and the time when companies feel their full impact. According to Dun & Bradstreet, failures reached a peak in October, 1980, when they rose to 56.8 per 10,000 listed enterprises, responding to the high levels of interest rates that prevailed in early spring. They then

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February, 1981 (the latest available). This, in turn, was traceable to the decline in interest rates that occurred during late spring and early summer. However, early estimates show that the number of bankruptcies has increased substantially in recent months. During the first seven months of 1981, they are believed to have surged by an estimated 40 per cent compared with the same period a year ago. Since relatively high interest rates are likely to continue through yearend if not longer, corporate casualties may remain high well into 1982.

Another important contributor to the decline in profits in several key industries was the rise in labor costs due to increases gained in collective bargaining settlements during the April-June period. Despite the substantial easing in the rate of inflation—to 6½ per cent during the second quarter as measured by the personal consumption expenditures deflator—wage adjustments negotiated during the second quarter (excluding cost-of-living clauses) averaged 12.2 per cent for the first year of the contract, up sharply from nine per cent in the first quarter and 9.5 in all of 1980. Since the average life of these contracts exceeds 2½ years, these increases will be felt for some time to come, and could become a serious obstacle in any further curbing of inflation.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 7/22/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	133.284	+ 1.061	+ 1.218
Loans to Depository Inst.	1.730	+ .435	+ 1.375
Float	3.137	– .139	– 1.741
Total Reserve Bank Credit	148.834	+ 1.662	+ 5.918
Treasury Deposits with Federal Reserve Banks	3.106	– .301	+ .383
Currency Outside Banks	125.738	+ .861	+ 8.122
Member Bank Reserves:			
Required	41.350	+ .855	– 2.363
Excess (Deficiency)	.237	+ .108	+ .226
Total Reserves Held	41.587	+ .963	– 2.137
Net Borrowed Reserves	1.249	+ .330	+ .911
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	94.911	– 1.351	+13.051

Monetary Aggregates †		% Change Since Three Months Ago*	% Change Since Year Ago
M-1A	360.0	0.0‡	– 3.8‡
M-1B	428.7	– 2.5‡	+ 8.0‡
M-2 (June '81)	1,749.5	+ 7.2	+ 10.1
L (April '81)	2,455.7	+ 7.9	+ 10.7

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 7/31/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	14.40%	14.40%	13.95%
* Federal Agencies	15.00	16.00	16.50
* Project Notes—Taxfree (46% Taxable Equivalent)	13.89	14.54	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	17.70	17.75	17.40

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	17.25%	Aug.	17.10%
15- 29 days	17.25	Sep.	17.00
30- 59 days	17.38	Oct.	16.80
60- 89 days	16.00	Nov.	16.65
90-179 days	15.50	Dec.	16.40
180-239 days	15.00	Jan.	16.10
240-270 days	13.00		

‡Industrial Paper—Prime		†Federal Funds Effective Rate	17.50%
30- 89 days	17.13%		
90-120 days	16.88		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period	Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'81 $ 2,881	$ 2,853	$ 2,565
Gross National Product (1972 Dollars)*	2nd Q'81 $ 1,509	$ 1,516	$ 1,463
Percent Change, Annual Rate	2nd Q'81 – 1.9%	8.6%	– 9.9%
Change in Consumer Prices (all urban consumers)*	Jun '81 8.4%	8.4%	12.0%
Change in Producer Prices*	Jun '81 7.2%	4.8%	9.6%
Civilian Employment (Thousands of Persons)†	Jun '81 98,392	99,235	96,780
Unemployment as % of Civilian Labor Force†	Jun '81 7.3%	7.6%	7.5%
Personal Income*	Jun '81 $ 2,382	$ 2,368	$ 2,127
Leading Indicators Composite Index (1967=100)†	Jun '81n 133.8	135.5	123.9
Industrial Production Index (1967=100)†	Jun '81 152.7	152.8	141.5
Net Change in Consumer Installment Credit†	May '81 $ 1.35	$ 2.33	–$ 2.68
U.S. Merchandise Trade Balance†	Jun '81n –$ 2.11	–$ 2.44	–$ 1.91
Plant and Equipment Expenditures*	3rd Q'81 $322.88(a)	$317.29(a)	$296.23
Private Housing Starts (Thousands of Units)*	Jun '81 1,032	1,159	1,184
New Construction Expenditures*	May '81 $ 237.3	$ 248.9	$ 221.6
Total Business Inventories†	May '81 $ 477.8	$ 474.6	$ 450.3
Total Business Sales†	May '81 $ 344.2	$ 345.7	$ 298.0

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

vis-a-vis the currencies of our major trading partners has depressed earnings of U.S. multinational companies. Since profits on foreign operations are first reported in the currency of that country, they translate into fewer dollars when the dollar is rising.

U.S. Trade Picture Is Mixed

But there is, as yet, no convincing evidence that the continuing strength of the dollar has damaged U.S. merchandise trade. On the one hand, the Census Bureau's release on U.S. merchandise trade (f.a.s. exports/c.i.f. imports) for June shows a slightly

billion in May and $3.5 billion in April. On the other hand, preliminary GNP data on merchandise exports suggest that in real terms there has been an intermittent decline since early last year. Thus, the evidence at this point is inconclusive.

There is little doubt that the strong dollar will hurt U.S. exports before long. At present, however, exports appear to be holding up well. In June, according to the Census Bureau, exports were up 5.3 per cent over May while imports grew by three per cent. Since January, exports have risen by 7.5 per cent over the same period in 1980 and imports have

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (7/15/81)	123,532	+ 1,184	+33,402
New York City (7/15/81)	29,640	+ 245	+ 8,270
Commercial Paper (7/15/81)	153,794	+ 2,261	+29,393

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/15/81)	180,797	– 741	+22,222
New York City (7/15/81)	53,038	– 506	+ 6,149

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/15/81)	443,358	– 334	+48,898
New York City (7/15/81)	106,408	– 8	+17,377

Financial Markets

	Friday 7/31/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	15.45%	– .15	+ 6.80
180-Day Bills†	16.10	+ .10	+ 7.26
Longest Bills†	15.95	+ .25	+ 7.03
Recent Issues:			
15⅞s 7/31/83	15.60	+ .04	
14s 6/30/85	15.75	+ .45	
14½s 5/15/91	14.65	+ .29	
13⅞s 5/15/11	13.87	+ .27	
Municipals:			
Bond Buyer–20 Bond Index* (7/30/81)	11.44%	+ .10	+ 2.85
Blue List Total ($ Million)	$ 869	– $ 43	– $ 63
30-Day Visible Supply ($ Million)	$1,598	– $ 77	– $ 607
Total	$2,467	– $120	– $ 607
Corporates:			
Moody's Aa Composite (7/30/81)	15.03%	– .09	+ 3.39
Money Mgr.–30-Day Supply ($ Million)	$7,501	– $286	+ $3,492
Stocks:			
Dow-Jones Averages:			
Industrials	952.34	+ 15.60	+ 17.54
Transportation	406.68	+ 4.51	+ 95.60
Utilities	109.59	+ 2.02	– .86
65 Stocks	371.63	+ 5.58	+ 34.17
Standard and Poor's 500 Stocks	130.92	+ 2.48	+ 9.71
N.Y.S.E. Composite Index	75.95	+ 1.35	+ 6.51
N.Y.S.E. Avg. Daily Vol. for Week (000's)	42,158	– 1,036	– 5,786

* 46% Taxable equivalent 21.19%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 7/31/81	Week Ago
Overnight	17.25%	18.75%
1 month	18.63	19.44
3 month	18.75	19.19
6 month	18.75	18.88
1 year	17.63	17.63
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	15.10%	15.05%
Long Term (7 to 15 yrs.)	15.00	15.00

FOREIGN EXCHANGE SPOT RATES

New York Opening (7/31/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02478	40.36
Canada	.8107	1.2335
Denmark	.1291	7.7438
France	.1712	5.8400
Germany	.4060	2.4632
Italy	.0008170	1224.00
Japan	.004180	239.25
Mexico	.04058	24.64
Netherlands	.3656	2.7355
Switzerland	.4683	2.1353
U.K.	1.8570	.5385

export growth to imports has not fallen over this six-month period is an indication that the U.S. is on the downward leg of the "J" curve.

But there is an upward leg to the "J" curve as well. And this suggests that we may soon see the United States trade deficit begin to increase. This is in line with the expectations of many private economists—not to mention the Commerce Department—who anticipate a higher trade deficit this year than last. The economies of many of our trading partners are in recession, reducing their demand for imports. At the same time, the performance of the United States economy has been relatively better so far this year, sustaining our demand for imports.

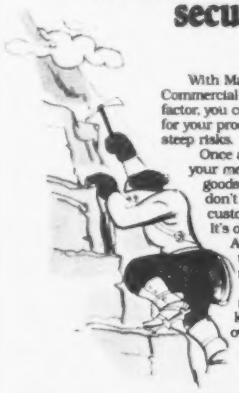
Petroleum imports, for example, skyrocketed almost 21 per cent last month over the preceding month. Some of the oil imports went to increase the government's strategic oil reserve—an optional import which can be discontinued if the trade deficit rises too sharply. But some of the increase was due to rising oil consumption. The price of oil, however, was stable at about $37 per barrel in May and June. This year the volume of oil imports has averaged close to 6.4 million barrels per day, down from seven million barrels per day in 1980. Further economy continues to soften.

Another important area of uncertainty is agricultural exports. Recent forecasts of another poor grain harvest in eastern Europe and the Soviet Union bode well for wheat, corn and soybean exports. So far this year, agricultural exports are an estimated 11 per cent ahead of last year in nominal terms, but when the effects of inflation are stripped away, volume growth has been small. It is probable that chemicals, aircraft and machinery will also show export growth this year. In June exports of manufactures were 14.9 per cent above the same month one year earlier. This trend is expected to continue throughout this year. But imports have also risen by the same percentage. If, as expected, the U.S. economy begins to grow again later this year, imports of manufactures may rise more rapidly and the expected decline in oil imports could be reversed.

Thus, in spite of a number of areas of uncertainty at this time, and anticipating that the present strength of the dollar will continue through the rest of 1981, exports will probably not grow sufficiently to reduce the trade gap and may, indeed, add a few billion dollars to last year's deficit. H

monetary muscle

Factoring to help consumer goods manufacturers secure their footing.



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